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E.O. 12958: DECL: 08/02/2017

TAGS: FFIN PGOV RS

SUBJECT: RUSSIA'S SUPREME ARBITRATION COURT RULES IN FAVOR  
OF PWC IN TAX CASE

REF: MOSCOW 3343

Classified By: Acting ECON M/C Kathleen Doherty, Reasons 1.4 (b/d).

Summary

**¶11.** (U) The Supreme Arbitration Court (SAC) has ruled in favor of PricewaterhouseCoopers Russia (PWC) following a July 10 hearing in which the Federal Tax Service (FTS) claimed PWC had improperly accounted for its expatriate employees' salaries in 2002. SAC Chairman Anton Ivanov dismissed the FTS claim, which had prevailed in the first and appellate instances at the Federal Arbitration Court level. The decision voided the FTS's use of representative samples as a basis for concluding that all of PWC's expatriate salary expense accounting was not in keeping with Russia's tax code.

Although the ruling leaves the door open for FTS officials to initiate a more comprehensive review of PWC's accounting practices for the year in question, it is also likely to influence the course of tax inspections going forward. End Summary.

Ruling in Taxpayers' Favor

**¶12.** (U) The Supreme Arbitration Court (SAC) has released the text of its formal decision in favor of PricewaterhouseCoopers Russia (PWC) following a July 10 hearing between the auditing firm and the Federal Tax Service (FTS). At issue in the one-day presentation of arguments was the FTS claim that PWC's practice of accounting for expatriate salary expenses during 2002 was unlawful and that, as a result, the auditor owed approximately USD 14 million in back taxes (reftel). Lower courts had upheld the FTS position in the initial instance and in two appeals.

**¶13.** (U) SAC Chairman Anton Ivanov, however, dismissed the earlier judgments against PWC in his two-part ruling. First, Ivanov placed the burden of demonstrating the impropriety of a given expense on tax officials. He indicated the tests for such a determination would be found in the volume, reliability and consistency of documents that companies furnish in the course of a tax inspection. Second, and closely related, the ruling invalidated the FTS' use of representative samples to conclude that PWC's expatriate salary expense accounting practices were inconsistent with Russia's tax code. The decision held that only the revenues and expenses that tax authorities actually checked could form the basis for any decision affecting PWC. The SAC has

remanded the case back to the Federal Arbitration Court for further review in light of the SAC's ruling on the Federal Tax Service's practices.

Comment

¶4. (C) Former PricewaterhouseCoopers Russia Managing Partner Mike Kubena (amcit) told Econoffs in late 2006 that, as part of this case, FTS officials had conducted only a small number of interviews with employees of PWC's clients who had had no contact with members of PWC's auditing teams. Kubena observed that these employees' responses formed the basis for the erroneous FTS conclusion that, because PWC did not employ expatriates, the expatriate salary expenses were therefore fraudulent. PricewaterhouseCoopers Russia's current Managing Partner Peter Gerendasi is hopeful that the outcome of this appeal will make tax inspections more transparent. End

Comment.

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